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### Constitutionalizing Financial Stability

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## The University of Chicago Law Review Online

POST

# Constitutionalizing Financial Instability

Patricia A. McCoy<sup>1</sup>

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*A part of the [Seila Law and the Roberts Court series](#).*

In the last Supreme Court term, the Court ruled in [Seila Law LLC v. Consumer Financial Protection Bureau](#) that Article II of the U.S. Constitution and separation of powers prohibit Congress from shielding the Bureau’s director from termination except for cause. *Seila Law* has natural implications for the CFPB’s independence (although the magnitude of that effect is unclear). More troubling, *Seila Law* could open up the financial system to destabilization by paving the path for a full-scale assault on the traditional independence of federal financial regulators and presidential manipulation of the economy.

Agency independence for federal financial regulators is a cherished historical tradition and a cultural norm. That independence protects the U.S. economy from unwise interference by the president for short-term political gain. When Congress authorized the creation of the CFPB in the [Dodd-Frank Act](#) in 2010, it reaffirmed that long-standing tradition by constituting the Bureau as “an independent bureau.”

This independent agency status plays a critical role by giving the CFPB the breathing room it needs to act in the best long-term interest of the economy. It helps the Bureau

resist political pressure from the president, moneyed interests, and Congress to relax credit restrictions and stimulate the economy in order to boost politicians' election prospects, with no regard for the risk of loan defaults further down the road. In this way, agency independence is intrinsic to long-term financial stability.

*Seila Law* erodes independent agency protections in the worst possible way, by enshrining its ruling as constitutional command. The constitutional basis of that ruling ossifies the law on independent agency safeguards and means Congress and the president cannot overturn it. The decision further exposes the CFPB, and possibly other federal financial regulators, to political strong-arming to chase short-term gains at potential expense to long-term financial stability. In the process, *Seila Law* damages the important ballast of economic health that agency independence provides.

## I. The *Seila* Holding Recapped

The events culminating in *Seila Law* date back to July 2010 and the enactment of the Dodd-Frank Act. Dodd-Frank was Congress's landmark response to the 2008 financial crisis and the ensuing economic carnage. Chief among the Act's achievements was the creation of a new federal banking regulator, the Consumer Financial Protection Bureau. Consistent with congressional tradition for all federal banking regulators, Congress designated the CFPB as an "independent bureau" and conferred it with guarantees of agency independence. One of those guarantees was a director appointed by the president for a five-year term. *Seila Law* challenged Congress's accompanying stipulation that the president could only fire the director of the Bureau for "inefficiency, neglect of duty, or malfeasance in office" and not at will.

In 2017, the CFPB, under the helm of Obama appointee Richard Cordray, issued a civil investigative demand (CID) to *Seila Law*, LLC, a California-based law firm providing debt relief and related services. The purpose of the demand was to ascertain whether the firm had "engag[ed] in unlawful acts or practices in the advertising, marketing, or sale of debt relief services."

Seila Law contested the demand, arguing that Congress’s decision to confer the Bureau with a single director who was only terminable for cause violated separation of powers. After the law firm refused to comply with the CID, the CFPB sued to enforce the demand. In federal district court, the Bureau prevailed, and the Ninth Circuit affirmed. Seila Law then successfully sought Supreme Court review. In the High Court, the CFPB, by then led by Trump appointee Kathy Kraninger, agreed that the CFPB’s structure was unconstitutional, but maintained that the for-cause removal provision was severable, rendering the CID enforceable.

In a 5–4 decision, the Supreme Court reversed. Writing for the Court, Chief Justice John Roberts held that the combination of a single agency director and termination only for “inefficiency, neglect, or malfeasance” violated Article II of the U.S. Constitution. Justice Elena Kagan, joined by Justices Ruth Bader Ginsburg, Stephen Breyer, and Sonia Sotomayor, dissented from that ruling, but concurred, along with Chief Justice Roberts and Justices Samuel Alito and Brett Kavanaugh, that the constitutionally infirm provision was severable. Justices Clarence Thomas and Neil Gorsuch dissented on the issue of severability. The Court remanded the case for determination of whether the CFPB had validly ratified the CID.

Chief Justice Roberts grounded the majority’s constitutional analysis in the “take care” clause of Article II, which vests “[t]he executive Power . . . in a President,” and commands the president to “take Care that the Laws be faithfully executed.” Although the Constitution nowhere has a removal clause, the majority reasoned that presidents cannot discharge the duty to “take care” unless they have the ability to remove appointees for any reason or none. Invoking history, the majority argued that the CFPB’s single-director structure lacked historical precedent. In addition, the for-cause removal provision “clash[ed] with constitutional structure by concentrating power in a unilateral actor insulated from Presidential control.”

In arriving at its holding, the majority had to dispose of a Supreme Court precedent upholding the identical for-cause removal language. In Humphrey’s Executor v. United States, the Supreme Court upheld the constitutionality of a statute protecting the

commissioners of the Federal Trade Commission (FTC) from termination except for “inefficiency, neglect of duty, or malfeasance in office.” This was the same standard that Congress applied to the CFPB director.

The *Seila Law* Court, however, distinguished *Humphrey’s Executor* as involving “a multimember body of experts, balanced along partisan lines, that performed legislative and judicial functions and was said not to exercise any executive power.” As a lone individual, the CFPB director was not a “body of experts” and could not be considered non-partisan in the same sense as a commission drawn from both political parties. The majority further distinguished *Humphrey’s Executor* on the ground that the CFPB director exerted significant executive powers, including the authority to promulgate binding rules, award relief in agency adjudications, and seek “daunting monetary penalties against private parties” in federal court.

The majority’s strong objections to the powers of the CFPB director dovetailed with its vision of a unitary executive. Under this view, the Framers deliberately concentrated the executive power in a strong president, “elected by the entire Nation” and politically accountable to it. The president could not “take Care that the Laws be faithfully executed” or be properly accountable to the people without the ability to dismiss inferior executive officers at will. If for-cause removal protection for the CFPB director remained intact, that would leave “significant governmental power in the hands of a single individual accountable to no one,” insofar as the director was “neither elected by the people nor meaningfully controlled (through the threat of removal) by someone who” was. Consequently, the Court struck down the for-cause removal protection for the CFPB director, sparing the CFPB but making the director terminable at will.

In short, the *Seila Law* case articulates an uncompromising commitment to a unitary executive. The majority opinion’s dogmatic tone and unwillingness to engage with countervailing arguments, however, weakened the opinion’s persuasive force.

## II. Independent Financial Regulators and

# Their Importance

Upon reading, the majority opinion comes off as hermetically sealed and deaf to contrary facts. Ironically, the conservative majority abjured a strict textualist approach to constitutional interpretation because the Constitution does not contain a removal clause. The majority ignored other text in the Constitution that undermined the Court's chosen unitary executive theory. It shrugged at *Humphrey's Executor's* lack of distinction between single agency heads and multimember commissions. Most curiously, the majority's reasoning embraced history as one of its two pillars, yet was silent about the nation's long tradition of independent federal financial regulators. This tradition has persisted for reasons that are vital to protecting the nation's economic health.

## A. The Constitution Contemplates Joint Decision-making Between the President and Congress on Executive Branch Design

In *Seila Law*, the majority opinion took new and aggressive steps to consolidate the removal power in the president and to limit Congress's ability to constrain that power. However, the majority's sole reliance on Article II as the basis of that holding was misplaced.

The majority disregarded at least two separate constitutional provisions that establish Congress's central role in executive branch design. The Necessary and Proper Clause in Article I of the Constitution gives Congress the power "[t]o make all Laws which shall be necessary and proper for carrying into Execution" Congress's enumerated powers and "all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." Similarly, the Appointments Clause empowers Congress to "establish[ ]" the principal officers of the executive branch "by law." Only when Congress creates an office may the president fill that office by appointing a principal officer, and only then may the appointment go forward upon the advice and consent of the Senate. Thus, the Constitution makes clear that Congress creates the

position of every principal officer of the executive branch and specifies the powers of each office.

The Constitution further places checks and balances on these powers. Through the veto power, the president can influence the institutional design decisions of Congress and ultimately reject them, subject only to congressional override. Similarly, the Senate, through its powers of advice and consent, can reject presidential nominations of principal officers.

Thus, the Constitution contemplates a symbiotic relationship, in which decisions about the features of agencies and agency leadership are the joint product of agreement between the president and Congress, through statutory enactments they both approve. Deeming Congress and the president best-equipped to decide on the executive branch's design, the Framers largely left decisions on institutional design to those two branches, not the judiciary. Over the succeeding two-plus centuries, this constitutional framework has given Congress and the president the flexibility they need to customize the design of executive branch agencies to the exigencies of the time.

## **B. This Nation's Tradition of Independent Financial Regulators Goes Back More Than Two Hundred Years**

Against this constitutional backdrop, Congress and the president have repeatedly enacted legislation insulating federal banking regulators from political influence by Congress and the White House. That history stretches back to the earliest days of the Republic, when Congress located the Treasury Department outside of the "executive departments"<sup>2</sup> and decreed that the comptroller of the Treasury's settlements of public accounts were "final and conclusive" and thus immune from reversal by the president. Next followed Congress's creation of the Second Bank of the United States in 1816, which by statute had twenty-five directors, only five of whom could be appointed or removed by the president.

Later, during the Civil War, Congress created the Office of the Comptroller of the

Currency (OCC) at President Lincoln's request to help fund the war. The OCC was the first federal banking regulator and ushered in the modern era of federal banking oversight. Originally, the president could only remove the comptroller with the consent of the Senate. But Congress revised that provision one year later to allow termination by the president acting alone, on the condition of "reasons to be communicated by him to the Senate."

Similar enactments ensued in the twentieth century. The 1913 legislation creating the Federal Reserve System stipulated that the governors of the Federal Reserve Board could only be removed for cause. In the Banking Act of 1933, Congress and the president created the Federal Deposit Insurance Corporation (FDIC) and named the Comptroller of the Currency as one of its directors. The creation of the CFPB followed seventy-seven years later.

Congress and the president, acting together, accomplished agency independence by enacting institutional features to lessen political pressure on federal banking regulators. Today, each of those regulators—the Federal Reserve System, the FDIC, the OCC, and most recently the CFPB—has independent funding, which exempts them from the congressional appropriations process. Congress and the president also gave the leadership of each federal banking regulator a fixed term exceeding five years and shielded the agency heads from firing at will without accountability to Congress. Federal banking regulators are similarly exempt from review of economically significant regulations by the White House Office of Information and Regulatory Affairs (more commonly known as OIRA). Some federal banking regulators enjoy even more independence—ranging from freedom from an annual audit by the Government Accountability Office (GAO) to the absence of budget caps—than the CFPB.

Federal banking regulators are not the only independent federal agencies. In the broader financial regulatory realm, count the Commodity Futures Trading Commission (CFTC), the Federal Housing Finance Agency (FHFA), the FTC, and the Securities and Exchange Commission (SEC). While the guarantees of independence that Congress bestowed on these bodies vary by agency, they all enjoy protection from political pressure.



Independent federal agencies also abound outside the financial sphere: they include the Environmental Protection Agency, the National Labor Relations Board, and the Social Security Administration, to name a few. In 2010, Justice Breyer counted fully forty-eight independent federal agencies with heads removable strictly for cause. These agencies have independence for a reason: to ensure that decisions in the best long-term interest of the country are made based on impartial technical expertise.

## **C. Independent Agency Status Helps Ensure That Decisions Requiring Technical Know-How Are Made in the Nation's Long-Term Interest**

The venerable tradition of independent federal agencies exists for good reason. In each case, Congress and the president wanted decisions by those agencies to be grounded in technical or scientific expertise, free from inordinate political pressure by Congress, by the White House, and by vested interests. In financial policy, the two branches further sought to avoid the distortions to the national economy that could result if a future president or Congress interfered with agency decision-making in order to boost their short-term electoral prospects. This freed federal financial regulators to act in the long-term interest of the economy, instead of being captive to the short-term election horizon of elected officials. The fear was that otherwise, political manipulation could wreak havoc on business and the financial system. In view of that fear, it comes as no surprise that most of the nation's independent financial regulators were created in response to a financial crisis: the Panic of 1907, in the case of the Federal Reserve System; the Great Depression, in the case of the FDIC, FTC, and SEC; and the Great Recession, in the case of the CFPB. Congress bestowed them with independence in order to force politicians and regulators to take a long-term view of the nation's economic, financial, and monetary stability.

When presidents lean on financial regulators to bolster their political prospects, usually their aim is to loosen credit to fuel spending and juice the economy. As alluring as this temptation is, Congress for decades has opted to curb it because relaxing credit standards can result in reckless lending that threatens financial stability. A short-term but

unsustainable credit-fueled asset bubble can result in a subsequent debilitating economic crash. Indeed, history has shown that the worst financial crises for centuries have been caused by real estate bubbles financed by loose credit.

In part to ensure decentralization of power throughout the administrative state, Congress and the president delegated the control of credit expansion to a variety of institutions, including the Federal Reserve System, the SEC, and the CFPB. Monetary policy, for instance, is the domain of the Federal Reserve System. Its main monetary tool consists of moving the target for the federal funds rate (which is the interest rate that banks pay to borrow reserve balances overnight). To stimulate demand for goods and services, the Federal Reserve can cut the federal funds rate, causing short-term interest rates to fall and credit to expand. Conversely, if demand overheats, the Federal Reserve can ease inflationary pressures by raising that rate. Cognizant of these stimulus powers, presidents have incentives to pressure the Federal Reserve to cut interest rates to improve their reelection prospects. But Congress restricts the president's influence over day-to-day monetary policy by protecting the Federal Reserve's governors from immediate dismissal.

The president may also try to lean on a host of federal financial regulators to expand credit through deregulation of lending standards. Over the years, Congress created multiple federal financial regulators and entrusted each with duties for the regulation of credit. For instance, to safeguard the solvency of depository institutions, the Federal Reserve Board, the FDIC and the OCC administer a host of statutes and rules that affect the supply and terms of loans by banks and thrifts. Similarly, the CFPB regulates market conduct for consumer finance and is the only federal agency that regulates the residential mortgage lending system in its entirety. The FTC and the CFPB share enforcement for consumer protection violations by nonbank lenders. Meanwhile, FHFA supervises the federal mortgage guarantors Fannie Mae and Freddie Mac.

Finally, capital markets regulators exert a critical effect on the supply of capital for lending. The SEC does so as the lead regulator for asset-backed securitizations and corporate debt issuances. The SEC and the CFTC also share oversight of credit default

swaps, which protect bond investors from defaults.

In each case, Congress balanced the constitutional requirement that the president take care that the laws be faithfully executed with the need to shield credit and monetary expansion from political interference. Protection from at-will termination has been Congress's preferred mechanism to achieve this balance for nearly 150 years.

The Supreme Court has repeatedly affirmed the legitimacy of independent agencies by upholding the constitutionality of for-cause removal provisions enacted by Congress. *Humphrey's Executor*, of course, confirmed the legality of such a provision in the context of the FTC. *Wiener v. United States* forbade the president from terminating members of the War Claims Commission at will. *Morrison v. Olson* held that an independent counsel empowered to investigate and prosecute high-level federal officials, including the president, could only be removed for cause. Even *Free Enterprise Fund v. Public Company Accounting Oversight Board*, which struck down a rare instance of double-layer for-cause protection, made the members of a federal accounting board terminable at will by SEC commissioners, but preserved the for-cause removal protection enjoyed by every SEC commissioner. As the majority in *Free Enterprise Fund* explained, it did not "take issue with for-cause limitations in general."

This account shows the heavily distorted nature of the majority's portrayal of history in *Seila Law*. The majority ignored the deeply embedded tradition of independent federal agencies in this country. It ignored the substantial Supreme Court precedent upholding that tradition and for-cause removal restrictions in particular. The majority opinion also was blind to the many ways in which independent agencies and the CFPB specifically are politically accountable.

## **D. The CFPB Remains Accountable through Numerous Other Means**

In *Seila Law*, the majority insisted that the "CFPB Director has no boss, peers, or voters to report to." But contrary to that assertion, the CFPB *is* politically and judicially

accountable. Both Congress and the president exert oversight of the Bureau through multiple other means.

First, it is critical to stress a general point: that independent agency heads with for-cause protection do in fact answer to the president. Those chiefs are not immune from presidential discharge for any and all reasons. To the contrary, they face termination either “for cause” (as in the case of Federal Reserve governors) or for “inefficiency, neglect, or malfeasance” (as in the case of FTC commissioners and, until recently, the director of the CFPB). Any independent agency head who violates the law can be fired by the president under this standard. For this reason, the for-cause standard in fact allows presidents to discharge their Article II duty to “take care that the Laws be faithfully executed.” Thus, it was blatantly false for the majority to maintain the CFPB director was “accountable to no one” in contravention of Article II, and made *Seila Law* wrongly decided.

Turning specifically to the CFPB, the Bureau is accountable to all three branches in a multitude of other ways. The Dodd-Frank Act commands the director to appear twice annually before the Senate Banking Committee and the House Committees on Financial Services and Energy and Commerce. In advance of those hearings, the Bureau must submit to the Committees and the president a comprehensive report on topics ranging from regulatory obstacles and objectives to budgetary justifications, as well as analysis of past and anticipated agency actions. Meanwhile, the GAO conducts an annual audit of the CFPB, and the Bureau also undergoes full review by the Federal Reserve’s Inspector General. Congress is free to exercise further oversight of the CFPB, and it has not hesitated to do so, judging from the number of times Congress has summoned CFPB officials to testify over the years. Ultimately, Congress can discipline the agency through legislation or the Congressional Review Act if it disapproves of the Bureau’s decisions. Congress’s decisions to strike down the CFPB’s indirect auto lending guidance and its mandatory arbitration rule are recent cases where Congress flexed that muscle.

The CFPB also operates under a hard budget constraint that other federal banking regulators do not face. The Dodd-Frank Act caps the agency’s budget at 12 percent of

the Federal Reserve System's fiscal year 2009 annual operating budget, indexed for inflation. In this way, Congress exerts the power of the purse on a continuing basis for the CFPB—something not done for any other bank regulator.

Other potent accountability mechanisms constrain the CFPB. Its enforcement actions and rulemakings are subject to judicial challenge and reversal in Article III courts.<sup>3</sup> And unlike with any other federal financial regulator, the Financial Stability Oversight Council (FSOC) can veto Bureau rulemakings that jeopardize financial stability. Also unlike most federal financial regulators, the CFPB must conduct cost-benefit analysis of its rules under the Dodd-Frank Act.

Against this background, several criticisms of the CFPB director as excessively powerful by the *Seila Law* majority are pure hyperbole. Take, for instance, the assertion that the CFPB “Director may unilaterally issue final decisions awarding legal and equitable relief in administrative adjudications.” The director's enforcement decisions are subject to judicial review and so, if challenged, are neither unilateral nor final. Indeed, the very fact that the *Seila Law* case resulted in partial Supreme Court reversal is a powerful testament to the accountability exercised by judicial review.

In another instance of hyperbole, the majority avowed that the CFPB director has “the power to seek daunting monetary penalties against private parties on behalf of the United States in federal court” and “levy[ ] knee buckling penalties against private citizens.” However, the director's enforcement authority in this respect is no larger than the civil money penalty authority of the federal prudential banking regulators or the SEC. Singling the CFPB out for this criticism when other federal financial regulators wield the same power smacks of a special, but unvoiced, distrust of regulators entrusted with consumer protection.

In a last exaggeration, the majority asserted that the CFPB director “may *unilaterally*, without meaningful supervision, issue final regulations . . .” (emphasis in original). Once again, however, CFPB rules are subject to the same Administrative Procedure Act review by Article III courts as other federal agency rules. Further, Congress can

countermand new CFPB rules under the Congressional Review Act. FSOC can reverse any Bureau rules that threaten financial stability. Given these multiple avenues for reversal, the CFPB in no way acts unilaterally when it promulgates rules. Nor are CFPB rules final as a practical matter until those review processes have played out. Finally, the Hill holds the ultimate power over CFPB rulemaking, because it can always override CFPB rules by statutory enactment, with no time limit.

In all of these ways, in sum, the CFPB *is* politically accountable. Nevertheless, the *Seila Law* majority put on blinders and ignored these safeguards of accountability. Having done so, the majority damned the Bureau as a law unto itself. That raises the question: if the Supreme Court was willing to compromise the CFPB's independence and override Congress in the process, is it poised to do so for other federal financial regulators as well?

### III. Does *Seila Law* Set a Dangerous Precedent?

*Seila Law* is the first Supreme Court case to curtail the independence of a federal financial regulator. Will it be the last? Language in that case gives reason for concern.

The majority opinion made no promises in that regard. All the majority was willing to do was to refrain from overturning past removal precedent in the *Seila Law* case itself. Thus, the majority said: “While we do not revisit *Humphrey’s Executor* or any other precedent today, we decline to elevate it into a freestanding invitation for Congress to impose additional restrictions on the President’s removal authority.” This less-than-reassuring language left the door open for reversing the Supreme Court’s for-cause removal precedent in the future.

Two members of the five-justice majority would have gone further and overturned *Humphrey’s Executor* outright. In his conurrence, Justice Thomas, joined by Justice Gorsuch, argued that leaving independent agencies “in place . . . subverts political

accountability and threatens individual liberty.” They also would have outlawed the entire CFPB as unconstitutional. In view of these extreme stances, it is hard to read this concurrence as anything other than a call for abolition of independent federal agencies across the board.

Beyond that, all five members of the majority signaled constitutional objections to other vital guard rails of CFPB independence. They objected to the Bureau’s independent funding. They objected to its single-director structure. They objected to the director’s five-year term, which exceeds the term of a president. Even more disturbingly, they attacked Congress’s designation of the CFPB as an “independent Bureau,” because by virtue of their decision, the CFPB head now must “implement the President’s policies upon pain of removal.” If this view were entombed as constitutional law, rulemakings by all federal financial regulators could be subject to OIRA (read: White House) review.

These broadside attacks are unnerving for anyone who values independent financial regulation and long-term economic stability. If the Federal Reserve Board lost independent funding and the governors lost their fourteen-year terms and their protection against removal save for cause, imagine the economic havoc a president could cause who was hell-bent on stimulating the economy through loose credit to boost the chance of reelection. The same goes for the FDIC. The Comptroller of the Currency and the director of the FHFA, as single agency heads, not multimember commissions, are in an even more precarious position. (Indeed, the Supreme Court just granted *certiorari* to examine the constitutionality of for-cause removal protection for the FHFA director).

It is not clear whether Chief Justice Roberts and Justices Alito and Kavanaugh have the appetite to wholesale erase the independent status of the Federal Reserve Board and other federal financial regulators. In a hopeful sign of moderation and concern to avoid judicial overreach, they did vote for severance and thus kept the CFPB intact.

Furthermore, *Seila Law* rests on a shaky analysis of history and case law, making it vulnerable to limitation or reversal if and when the philosophical configuration of the Supreme Court reverses.



Still, the future remains unsettled. Even if a conservative Court were unwilling to abolish independent agencies outright, it could achieve the same effect by picking away at attributes of agency autonomy, for instance, by striking down independent funding here and long fixed terms there. The upcoming Supreme Court decision in the FHFA director case will be telling, particularly if by that time mortgage delinquencies have spiked in the wake of the global pandemic and high unemployment. Will the Court be prepared to allow the president to fire the FHFA director for refusing to approve lax mortgage credit? Has the Court boxed itself in to that result with *Seila Law*? Or will the Court hold the line against rash political pressure by the White House that could have ruinous long-term economic consequences?

It is all too easy for first-term presidents, faced with possible defeat at the polls, to put their short-term career interests ahead of the long-term financial stability of the nation. Agency independence and the job security that comes with for-cause removal increase the chance that federal financial regulators will act in the people's best interest by protecting the economy's long-term health. By constitutionalizing the president's prerogative to fire the CFPB director for refusing to relax credit to produce a short-term boom, the *Seila Law* decision tread a dangerous path for the nation's financial security.

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August 27, 2020 / CFPB, Dodd-Frank, financial regulation, independent agencies, Seila Law series